

BEFORE THE DEPARTMENT OF COMMERCE
OF THE STATE OF MONTANA

In the matter of the amendment of) NOTICE OF AMENDMENT
ARM 8.99.401, 8.99.404, 8.99.501,)
8.99.502, 8.99.504, 8.99.505,)
8.99.509, and 8.99.511 pertaining to)
microbusinesses)

TO: All Concerned Persons

1. On November 8, 2007, the Department of Commerce published MAR Notice No. 8-99-59 pertaining to the public hearing on the proposed amendment of the above-stated rules at page 1730 of the 2007 Montana Administrative Register, Issue Number 21.

2. A public hearing was held on November 29, 2007. No testimony was received; however, several written comments were received by the December 7, 2007, deadline.

3. The department has thoroughly considered the comments received. A summary of the comments received and the department's responses are as follows:

8.99.401 DEFINITIONS

COMMENT 1: One comment was received regarding the deposit of development loan funds as a loan guarantee and whether this deposit arrangement would still be allowed with the proposed control agreement.

RESPONSE 1: The use of development loan funds for establishing a revolving loan fund from which loans made directly by banks to qualified microbusinesses are guaranteed is provided for under statute and the administrative rules. As amended ARM 8.99.505(6) includes: "The guarantee agreement between the bank and the MBDC must be approved by the department." Therefore, the "guarantee agreement" would include a deposit account control agreement that is satisfactory to the bank and the department, which the department believes could be developed. Therefore, the required control agreement would allow for this deposit arrangement.

8.99.504 DEVELOPMENT LOAN – TERMS

8.99.504(1)

COMMENT 2: One comment was received opposing the proposed eight-year term for the department's development loan, because it would cause a financial hardship. The commenter also stated that there is no explanation provided as to why the department would recall the development loan.

RESPONSE 2: The department agrees with the comment and the amendment to ARM 8.99.504(1) will be stricken. The provision for recalling the department development loan is provided in ARM 8.99.401(3) which states: "'Default' shall be defined in the development loan agreement between the department and MBDC."

8.99.504(5)

COMMENT 3: Several comments were received concerning the requirement that each MBDC provide a "fidelity bond" covering all MBDC employees having access to development loan funds.

RESPONSE 3: The department agrees with the comments and is amending ARM 8.99.504(5) accordingly.

8.99.504(6)

COMMENT 4: Many comments were received opposing the mandated development loan funds' loan out rate.

RESPONSE 4: The department agrees with the comments and is amending ARM 8.99.504(6) accordingly.

8.99.504(7)

COMMENT 5: A comment was received requesting a change in the calculation of the loan out rate to include subtracting the required cash loan loss reserves from the MBDC capital amount, if cash loan loss reserves are required.

RESPONSE 5: The rule amendment is only pertinent to department development loan funds; therefore, only department development loan funds are included in the calculation. In addition, the department will not require "cash loan loss reserves".

8.99.504(10)

COMMENT 6: Several comments were received that opposed requiring the MBDCs to submit a budget to the department which forecasts revolving loan fund income and expenses.

RESPONSE 6: 17-6-407, Section 7, MCA, states: "Development loan funds may not be: (b) used to: (ii) pay the operating costs of a certified microbusiness development corporation". 17-6-408, MCA, states: "The department may certify: (1) a microbusiness development corporation when it determines that the corporation: (c) has an adequate source of operating capital". Therefore, the required budget ensures MBDC statutory compliance.

8.99.504(11)

COMMENT 7: A comment was received opposing the department procuring the services of an independent certified public accountant to prepare annual audits of each MBDC.

RESPONSE 7: 17-6-407, Section 10, MCA, states: "Each certified microbusiness development corporation that receives a development loan under this part shall provide the department with an annual audit from an independent certified public accountant. The audit must cover all of the microbusiness development corporation's activities and must include verification of compliance with requirements specific to the microbusiness program." Therefore, the administrative rule ensures statutory compliance.

8.99.504(12)

COMMENT 8: Many comments were received opposing a separate demand deposit account.

RESPONSE 8: 17-6-407, Section 11, MCA, states: "A development loan is secured by a first lien on all funds and all receivables administered under the authority of the microbusiness development act by the corporation receiving the loan."

Security interests in deposit accounts as original collateral are within the scope of Article 9 of the Uniform Commercial Code. As provided for under Article 9, the most practical method for the department to perfect a "first lien on all funds", as directed by statute, is for the department to require a separate revolving loan fund deposit account and corresponding account control agreement. A separate account is needed so that the department does not gain control over other lender and/or investor funds.

8.99.504(14)

COMMENT 9: Several comments were received opposing the use of deposit account control agreements to secure the development loan.

RESPONSE 9: 17-6-407, Section 11, MCA, states: "A development loan is secured by a first lien on all funds and all receivables administered under the authority of the microbusiness development act by the corporation receiving the loan." As provided for under Article 9, the most practical method for the department to perfect a "first lien on all funds", as directed by statute, is for the department to require a separate deposit account and corresponding account control agreement.

8.99.511 MICROBUSINESS LOANS - ELIGIBILITY FOR AND TERMS AND
CONDITIONS

8.99.511(3)

COMMENT 10: Many comments were received opposing a maximum loan term of eight years for microbusiness loans.

RESPONSE 10: The department agrees and the amendment to ARM 8.99.511(3) will be stricken.

8.99.511(6)

COMMENT 11: A comment was received requesting clarification that development loan funds may not be used to refinance a delinquent or nonperforming loan or a portion of a delinquent or nonperforming loan held by a bank.

RESPONSE 11: 17-6-407, Section 7, MCA, states: "Development loan funds may not be: (b) used to: (i) refinance a nonperforming loan held by a financial institution". The purpose of the rule amendment is to ensure statutory compliance. It is not the intent of the department to "preclude restructuring of an existing delinquent or nonperforming microbusiness loan" originated with development loan funds and which are held in the revolving loan fund.

8.99.511(7)

COMMENT 12: A comment was received regarding the eligible uses of the cash proceeds of a microbusiness loan.

RESPONSE 12: The department agrees with the comment and will amend ARM 8.99.511(7) accordingly.

4. The department has amended ARM 8.99.404, 8.99.501, 8.99.502, 8.99.505, and 8.99.509 as proposed.

5. The department has amended ARM 8.99.401, 8.99.504, and 8.99.511 as proposed, but with the following changes, stricken matter interlined, new matter underlined:

8.99.401 DEFINITIONS As used in this subchapter, the following definitions apply:

(1) through (3) remain as proposed.

(4) remains as proposed, but is renumbered (6).

(4) "Defaulted loan" means a loan that the borrower has failed to make three or more timely payments of principal and interest, or whose payments of principal and interest are greater than 90 days past due or has otherwise failed to comply with the terms and conditions of the loan agreement.

(5) remains as proposed, but is renumbered (7).

(5) "Delinquent loan" means a loan that the borrower has failed to make one or two timely payments of principal and interest, or whose payment of principal and interest are greater than one day and less than 90 days past due.

(6) through (18) remain as proposed, but are renumbered (8) through (20).

(19) through (21) remain as proposed, but are renumbered (22) through (24).

(21) "Performing loan" means a loan that the borrower is current in its compliance or satisfaction of all loan agreement terms and conditions. A performing loan is not a defaulted, delinquent, or restructured loan.

(22) remains as proposed, but is renumbered (25).

(23) through (26) remain as proposed, but are renumbered (27) through (30).

(26) "Restructured loan" means a defaulted or delinquent loan that has had its original loan agreement terms and conditions modified by the lender. The agreement to restructure may result from noncompliance or nonsatisfaction of all the loan agreement terms and conditions by the borrower or legal action against the borrower or may simply be an agreement to which both the lender and the borrower consent.

(27) through (29) remain as proposed, but are renumbered (31) through (33).

8.99.504 DEVELOPMENT LOAN - TERMS (1) Development loans shall be renewable at intervals of no more than four years. ~~If the department requires or agrees to restructure a development loan to expedite the repayment of the loan, the term of the restructured loan shall provide for the repayment of the restructured loan in an efficient and prudent manner and shall not exceed eight years.~~

(2) through (4) remain as proposed.

(5) The loan agreement will require fidelity bonding the MBDC to purchase and maintain insurance protection from the loss of development loan funds due to the dishonest or fraudulent activities of the employees of the MBDC. The insurance must provide coverage of all MBDC employees having access to development loan funds in an amount equal to or greater than the total outstanding indebtedness of the MBDC that has been issued by the department to the MBDC under the authority of the Microbusiness Development Act, as follows:

~~(a) a fidelity blanket position bond insuring the MBDC in an amount equal to or greater than the total outstanding indebtedness of the MBDC that has been issued by the department to the MBDC under the authority of the Microbusiness Development Act is acceptable to the department in meeting the fidelity bond requirement. "Fidelity blanket position bond" refers to a fidelity bond where blanket coverage is granted for all employees in the regular service of the MBDC during the term of the bond. The bond is issued for a fixed sum and each employee of the MBDC is covered up to the full amount of the bond.~~

(6) The initial department development loan to a certified MBDC shall not exceed the maximum amount the certified MBDC can reasonably be expected to lend to eligible microbusinesses, in an effective and sound manner, within two years after loan closing. After two years from the closing of the initial development loan, at least ~~70~~ 60 percent of the total principal balance of the certified MBDC's development loan shall be loaned out to eligible microbusinesses. The loan out rate shall be calculated as follows: total revolving loan fund microbusiness loan receivables multiplied by .86, divided by the total development loan principal balance outstanding.

(7) On a quarterly basis, all MBDCs shall report, in writing, the total revolving loan fund microbusiness loan receivables and the resulting loan out rate to the department. If the reported loan out rate falls below the ~~70~~ 60 percent loan out rate standard for a 12 month period, the MBDC shall return the excess funds to the

department by the fifth day following the end of the next calendar year quarter. The dollar amount of development loan funds equivalent to the difference between the actual percentage of development loan funds loaned out and the ~~70~~ 60 percent loan out rate standard is referred to as "excess funds". If excess funds are returned by the MBDC to the department, a certified MBDC may apply for additional development loan funds in the future, provided that the certified MBDC meets the requirements established in ARM 8.99.502.

(8) and (9) remain as proposed.

(10) The MBDC shall submit a budget to the department which forecasts revolving loan fund income and expenses. The amount ~~removed~~ withdrawn from the revolving loan fund bank account shall not exceed the amount in the MBDC's budget that is approved by the department. Revolving loan fund income may be used to create and maintain a funded loan loss reserve. ~~The MBDC shall create and maintain a funded loan loss reserve that is equal to six percent of the total outstanding microbusiness loan receivables. The funded loan loss reserve may be accumulated over the initial two years of the development loan. The funded loan loss reserve shall be maintained for as long as any part of a development loan to a MBDC remains unpaid. The department in consideration of, but not limited to, MBDC audits and loan loss and delinquency records may require additional revolving loan fund income be used for increasing the funded loan loss reserve.~~

(11) through (14) remain as proposed.

8.99.511 MICROBUSINESS LOANS - ELIGIBILITY FOR AND TERMS AND CONDITIONS (1) and (2) remain as proposed.

(3) The dollar value of all microbusiness loans having repayment terms of more than five years may not exceed 15% of the total dollar value of all microbusiness loans made by an MBDC. repayment term of any individual microbusiness loan receivable in the revolving loan fund shall not exceed eight years.

(4) through (6) remain as proposed.

(7) Eligible uses of the cash proceeds of a microbusiness loan by a microbusiness include:

(a) and (b) remain as proposed.

(c) purchase of equipment, leasehold improvements, machinery, or supplies; and

(d) start-up operating costs and working capital; and

(e) consolidation and/or the paying off of a number of performing loans originated and held by banks, of which the microbusiness is the debtor.

/s/ G. MARTIN TUTTLE
G. MARTIN TUTTLE
Rule Reviewer

/s/ ANTHONY J. PREITE
ANTHONY J. PREITE
Director
Department of Commerce

Certified to the Secretary of State March 3, 2008.